

ILLINOIS COMMERCE COMMISSION

Reconciliation of revenues collected under gas adjustment charges with actual costs prudently incurred.

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Docket 00-0714

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I. SUMMARY OF ILLINOIS POWER'S EXCEPTIONS

Illinois Power Company's ("Illinois Power", "IP" or "Company") takes exception to two of the conclusions in the Proposed Order ("PO") in this docket. First, Illinois Power takes exception to the conclusion that IP's decision to retire its Freeburg propane plant was imprudent. (PO, §IV.B.4) This PO conclusion is incorrect and unwarranted for the following reasons, among others:

- (1) The PO conclusion imposes as a standard of prudence a requirement that a present value of future revenue requirements ("PVRR") analysis of the decision to retire the plant versus continuing to operate it should have been conducted, even though that requirement is contrary to the guidance a utility would get from prior Commission decisions. The PO conclusion therefore constitutes arbitrary and irrational regulation.
- (2) Assuming that consideration of PVRR studies in the prudence analysis is appropriate, the PO conclusion uses an inappropriate value for the cost of replacement pipeline firm transportation ("FT") capacity that would be used to replace the capacity of the propane facility. With appropriate assumptions and consideration of alternative scenarios, the PVRR analyses show that retirement of the Freeburg propane facility was a reasonable and prudent decision.
- (3) The PO conclusion gives insufficient weight to the safety and reliability concerns associated with continuing to operate a 30 year-old facility that requires handling and maintenance of an 800,000 gallon propane inventory stored in an above-ground tank, carrying with it the risk (however remote) of a catastrophic accident that could do considerable damage to structures in the surrounding area as well as placing employees, emergency response personnel and residents of the surrounding area at risk. Safety, reliability, flexibility and other considerations were sufficient to justify retiring the Freeburg facility as a prudent decision, particularly in light of the debatable PVRR results presented in this case

Second, Illinois Power takes exception to the PO conclusion that IP's practice of awarding firm supply reservation contracts, which are entered into for the purpose of providing adequate winter gas supply capacity but carry no obligation for IP to purchase any

gas, solely on the basis of lowest capacity reservation cost, was imprudent. (PO, §IV.D.5) This conclusion, like the PO conclusion regarding the Freeburg propane plant, is arbitrary and irrational because the Commission found that same practice to be prudent in last year's (1999) PGA reconciliation case. Further, adopting the practice recommended by Staff would require IP to engage in a mathematical exercise the accuracy of whose outcome will be overwhelmed by the uncertainty of the assumptions underlying it, and which will provide no useful contribution towards prudent decision making. The record shows that IP's practice of basing contract awards for firm capacity reservation contracts on lowest reservation cost is reasonable and prudent. In addition, IP takes exception to the PO conclusion that any excess gas costs resulted from this practice; the record shows that in the aggregate IP realized gas cost savings in 2000 from all of its firm capacity reservation contracts selected on the basis of lowest reservation cost.

II. ILLINOIS POWER'S DECISION TO RETIRE THE FREEBURG PROPANE PLANT WAS REASONABLE AND PRUDENT

A. The PO Is Incorrect in Concluding that Illinois Power Should Have Performed a PVRR Analysis in Deciding to Retire the Freeburg Propane Facility

In April 2000, Illinois Power decided to retire its Freeburg propane facility. This facility, which was 30 years old, was the last of IP's five propane plants; the other four plants had been retired in 1994 (two), 1995 and 1996. (Rev. IP Ex. 3.2, pp. 3-5) The Freeburg facility stored propane in liquid form in an 800,000 gallon, refrigerated above-ground storage tank. (Id., pp. 2-3; IP Ex. 3.6, p. 6; Rev. IP Ex. 4.3, p. 2) The volume of propane needed to fill the 800,000 gallon storage tank was equal to 90 transport truck deliveries. (IP Ex. 3.6, p. 12) This inventory was sufficient for about three days of operation. (Id., pp. 7, 14; Tr. 35)

Section IV.B.2.a of the PO summarizes IP's reasons for deciding to retire the Freeburg propane facility. In brief, the Company based its decision to retire the facility on safety concerns associated with the need to transport, handle and maintain an 800,000 gallon liquid propane storage inventory, the growth of development in the surrounding area, the need for substantial capital expenditures on the facility and for additional expenditures in the future as the plant continued to age, the likelihood of more stringent regulations becoming applicable to the facility, and the lesser risk and greater reliability and convenience associated with using pipeline FT to obtain the same amount of supply capacity. (See IP Init. Br., p. 1)

At the time it decided to retire the Freeburg propane facility, Illinois Power did not perform a PVRR analysis, and did not believe a PVRR analysis was necessary given the compelling reasons supporting the retirement decision. Staff contended that IP should have performed a PVRR analysis. The PO concludes that:

The Commission believes that an examination of the prudence of a utility decision in a PGA reconciliation proceeding should include an economic or PVRR analysis unless the reasons supporting the utility's decision are so significant and persuasive that they render an economic analysis unnecessary. The Commission rejects IP's position that an economic analysis should never be part of an examination of the prudence of utility decisions in a PGA reconciliation proceeding. (PO, p. 17)¹

* * * *

. . . The Commission does not believe that safety and reliability concerns are so significant that they preclude the need for an economic or PVRR analysis as part of the decisions as to whether the plant should be retired. (PO, p. 18)

¹ It is not IP's position that "an economic analysis should never be part of an examination of the prudence of utility decisions in a PGA reconciliation proceeding." IP's position is that a PVRR analysis was not necessary in deciding to retire the Freeburg propane plant, and that the fact that IP did not perform a PVRR analysis at the time the plant was retired does not make that decision imprudent.

Based on the facts and circumstances relating to the decision to retire the Freeburg propane facility, these conclusions are inappropriate and incorrect.

In determining whether to accept or reject the PO's conclusion that Illinois Power should have conducted a PVRR analysis in deciding whether to retire the Freeburg propane plant, the Commission must consider the guidance provided by its prior orders. This guidance informs the actions of regulated utilities and thus helps to shape the standards of conduct which can reasonably be applied in determining whether IP engaged in prudent decision-making with respect to this asset.

The economic decision facing Illinois Power was whether to make capital expenditures that were needed for various replacements and upgrades of equipment at the Freeburg facility in order to continue to be able to operate it; or to retire the facility, thereby avoiding the need for those capital expenditures (and for ongoing operating costs and additional, future capital improvements) and instead contract for pipeline FT capacity to replace the capacity of the Freeburg plant. Staff and IP were in agreement that the capital expenditures immediately needed in 2000 in order to continue operation were at least \$1,873,000.² (See IP Init. Br., p. 4) Previous Commission orders have indicated that PVRR or other "net economic benefits" analyses are not a necessary requirement in determining the prudence of capital projects of this size.

For example, in IP's last gas rate case, Docket 93-0183, the Commission considered whether numerous capital projects were prudent and reasonable and should be included in IP's gas rate base. The first of these projects was the Hillsboro Storage Field and pipeline

² As noted in the PO (p. 6), Staff also accepted additional costs identified by Packer Engineering of \$75,000 for a comprehensive inspection of the 800,000 gallon storage vessel and \$30,000 to update engineering documentation.

project; IP presented various PVRR analyses in support of including this project in rate base. However, the cost of the Hillsboro Project was \$57.4 million, much, much higher than the \$1.9 million investment involved in this case. (See Order in Docket 93-0183 (Apr. 6, 1994), p. 4) In addition to the Hillsboro Project, the Commission also considered and allowed in rate base, in Docket 93-0183, eight other new capital projects, only one of which IP justified with a PVRR analysis. Each of these eight projects involved a larger capital expenditure than the \$1.9 million expenditure that would have been required in 2000 to continue to operate the Freeburg facility. The Commission expressly found all eight of these projects to be prudent and reasonable. (*Id.*, pp. 12-18) With respect to a tenth project, Staff opposed its conclusion in rate base because IP had not presented a net economic benefits analysis of the project. The Commission, however, rejected Staff's argument:

Staff witness Lounsberry proposed that the costs of the construction tracking feature and the marketing and expanded services feature be excluded from rate base. ***In proposing their exclusion, Staff emphasizes that the Company has not shown that the benefits of these features outweigh the costs to ratepayers*** (Initial Brief, pp. 60-61). Staff notes that the IP witnesses testified that the quantified "savings" for the construction and tracking feature would not cause O&M expense reductions to ratepayers. Staff states that while this feature may cause an immediate benefit to IP, this is not an adequate basis for recovery of its cost from ratepayers. Staff concludes that IP has not shown how this feature provides needed benefit to customers.

Similarly, Staff asserts that IP has failed to show how the marketing and expanded services feature provides benefits to ratepayers. Staff indicates that IP witnesses made an unsubstantiated statement that this feature would enhance customer service. Staff asserts that IP failed to show that its customers desire or need the specific information available from this feature.

In response, the Company indicates that Staff's proposed standard, a strict cost/benefit test, is not appropriate for these two features. ***IP emphasizes that its decision to implement CIS was not based on a strict cost/benefit analysis which compared its costs to explicit O & M expense savings that it would produce***. IP indicates that such a test would fail to account for the non-quantifiable, intangible benefits that drove it to implement CIS.

IP also asserts that its evidence establishes that both of these features will provide benefits to customers. IP concludes that these two features, like the overall CIS project, are justified based on their overall benefits, including improved service to customers.

The Commission concludes that the costs of the construction tracking feature and the marketing and expanded services feature should be included in rate base. *Staff's strict cost/benefit test for these features is an inappropriate standard that is not found in the Public Utilities Act.* The Company's evidence concerning the increased efficiency and the improve customer service that would result from these features justifies the inclusion of the costs of these features in rate base. (Order in Docket 93-0183, pp. 24-25; emphasis added)

Similarly, in Docket 91-0147 (IP's last electric rate case), Staff argued that the "BFMS" project, which had a capital cost of \$10.7 million, should not be allowed in IP's rate base because "IP has failed to present evidence that BFMS provides a net economic benefit to ratepayers." The Commission, however, concluded that "While Staff proposes that a proper, net present value economic benefits test pertaining to BFMS should have been performed by IP, the Commission cannot conclude that failure to perform such a test is a sufficient basis for excluding BFMS from rate base. Therefore, Staff's proposed adjustment is rejected." (Order in Docket 91-0147 (Feb. 11, 1992), pp. 43, 48)

Illinois Power agrees that the PO sets forth an appropriate standard of prudence, namely, "Prudence is that standard of care which a reasonable person would be expected to exercise under the same circumstances encountered by utility management at the time decisions had to be made." (PO, p. 16) However, that "standard of care" is formulated, at least in part, by the standards and criteria articulated in prior regulatory decisions. As the forgoing discussion shows, in Illinois Power's previous rate cases in which the prudence of capital projects involving even more money than the Freeburg facility were at issue, the Commission did not require a PVRR analysis as part of the "standard of care" for prudence.

In light of its prior orders, it would be arbitrary and irrational regulation for this Commission to now hold that IP should have known that it needed to conduct a PVRR analysis of retiring versus continuing to operate the Freeburg plant, or be subject to a gas cost disallowance.

Moreover, the projects involved in Dockets 91-0147 and 93-0183 were new capital additions projects. Here, the project in question was a 30 year-old propane plant for which safety and reliability were already becoming increasing concerns. To prudently invest an additional \$1.9 million to keep the Freeburg propane plant operational would necessitate that there be reasonable confidence that the facility could then continue to be operated over an extended future period in order to recover the investment. Under these circumstances, it would be unreasonable to base a determination to spend \$1.9 million to be able to continue to operate the Freeburg propane plant on a PVRR analysis whose results are dependent on the accuracy of the underlying assumptions used regarding conditions over the ensuing 15 to 30 years that the plant would have to be operated to justify that capital expenditure. Such a reliance on PVRR analyses would be particularly problematic given, as shown in this case, that reasonable changes in the assumptions used result in changes in the conclusion of the PVRR analyses.

In addition, there is the fact that Illinois Power previously retired its other four propane facilities without conducting PVRR analyses and without any objection from Staff in the PGA reconciliation dockets for the years in which those plants were retired.³ The PO states that “the retirement of the other four propane plants without the consideration of a PVRR analysis is not determinative of whether a PVRR analysis should be part of the decision to retire the Freeburg plant”, because “[t]here has been no showing that the

circumstances for retiring the other four plants are the same as those pertaining to the retirement of the Freeburg plant.” (PO, p. 17) The PO’s rationale would put an unreasonable burden on management to guess at when a PVRR analysis would need to be performed to satisfy the Commission’s standards of prudence. In light of a history of retirement of four other propane plants in the preceding six years with no performance of a PVRR analysis and no demands from Staff or Commission that such studies be conducted, it would be unreasonable for the Commission to conclude that IP should have known that in order to be deemed “prudent”, it needed to conduct a PVRR analysis of the decision to retire the fifth and final propane facility.

B. The PO Erroneously Concludes That a Proper PVRR Analysis Shows It Would Have Been More Economic to Make the Capital Investment Necessary to Continue to Operate the Freeburg Propane Plant Than to Retire It

While Illinois Power believes that a PVRR analysis was not necessary in determining whether to retire the Freeburg propane plant, the Company also believes that the PVRR analyses presented in this case demonstrate that retirement of the Freeburg facility was a reasonable and prudent decisions.

As the PO notes (p. 18), Illinois Power and Staff agreed on many of the inputs and assumptions that should be used in the PVRR analysis, including most notably the minimum capital expenditures (approximately \$1.9 million) that would have been required in 2000 in order to continue to operate the Freeburg facility. The PVRR values for continuing to operate the facility over 15 and 30-year periods reported on page 18 of the PO are the values

³ Dockets 95-0122 (Dec. 9, 1998) (1994 PGA reconciliation), 96-0035 (Dec. 9, 1998) (1995 PGA reconciliation), and 97-0018 (Nov. 5, 1998) (1996 PGA reconciliation).

from IP's base case analysis.⁴ As the PO also notes, however, whether the PVRR values for retirement of the plant are higher or lower than the base case PVRR values for continued operation depends on the assumption used for the cost to purchase pipeline FT capacity to replace the capacity of the Freeburg plant.

Staff's analysis used the cost, provided by IP in discovery, to purchase an amount of pipeline FT capacity equivalent to the capacity of the Freeburg plant on a year-round basis. However, the sole purpose of the Freeburg propane facility was to provide additional peaking capability on the most severely cold winter days; it would not have been used outside the five winter season months.⁵ Accordingly, IP's PVRR analyses used a cost to purchase the equivalent amount of pipeline FT capacity for only the five winter months. The cost used by IP appropriately reflected the fact that purchase of pipeline FT capacity for only the five winter months would come at a premium price (on per-day or per-month basis) to the price that the pipeline would charge for the capacity under a 12-month contract. Nevertheless, the total cost to purchase the necessary pipeline FT capacity for only the five winter months would be less than the total cost to purchase the same amount of pipeline FT capacity under a 12-month contract. Based on purchasing replacement FT capacity for only the 5 winter season months, rather than on a year-round basis as assumed by Staff, the PVRR values for

⁴ The PVRR values for continued operation reported on page 18 of the PO do not reflect, however, plausible higher capital expenditure requirements that IP included in an alternative PVRR analysis based on the conclusions of Packer Engineering's safety evaluation of the Freeburg facility. (See IP Ex. 3.6, pp. 7-9; IP Rep. Br., pp. 15-16) Inclusion of these higher capital expenditure requirements increased the PVRR for continued operation of the facility (relative to retirement) by \$1,264,947 over 15 years and by \$1,412,658 over 30 years. (See id.) At a minimum, this alternative should be taken into account in the evaluation as a sensitivity that helps to define the range of potential outcomes.

⁵ IP typically operated its propane plants only a few days each winter season. The Freeburg facility had only been called upon to produce system supply gas a total of six times from 1995 through 1999. (Rev. IP Ex. 3.2, p. 4; IP Ex. 3.6, p. 13)

retiring the Freeburg facility are less than the PVRR values for continued operation of the plant, over both the 15 and 30-year study periods. (See IP Ex. 3.6, pp. 6-7; IP Init. Br., pp. 11-12; IP Rep. Br., pp. 11-13)

In his testimony on this topic, Company witness Frank Starbody observed that the pipeline market has evolved in recent years on the issue of whether FT capacity could be economically purchased for the winter season only, rather than under a 12-month contract. He noted that “the availability of winter-season only FT on an economical basis was less clear in April 2000 than it was by 2001”, but that “the market has evolved such that it is now more economical to purchase FT for the winter season (November through March) only, albeit at a price premium over summer season (April through October) rates.” (IP Ex. 3.6, pp. 5, 9) The PO does not take issue with the facts that replacement FT capacity for Freeburg would only be needed during the five winter months, and that it is now more economical to purchase FT capacity on a winter-season only basis than on a 12-month basis. (See PO, p. 19) However, the PO seizes upon Mr. Starbody’s statement that it was “less clear” in April 2000 that such a purchase was possible than it had become by 2001, to reach the following conclusion:

Since it was not reasonable prior to April 2000 to assume that it was economical for IP to purchase FT capacity for the winter season only, the Commission concludes that Staff’s PVRRs for the retirement of the Freeburg plant are reasonable and should be accepted. IP’s PVRRs for the retirement scenarios rely on information not known at the time that the decision to retire the Freeburg plant was made and, therefore, constitute an impermissible hindsight analysis.

The Commission determines that the significant PVRR savings from the continued operation of the Freeburg propane plant of \$5,297,160 for the 30-year period and \$3,942,149 for the 15-year period outweigh the concerns about the safety and reliability of the plant identified by IP as the plant continues to age. Therefore, the Commission concludes that IP’s decision to retire the Freeburg plant in April 2000 was imprudent. (Id.)

The PO's conclusion is unreasonable for several reasons. First, it is unreasonable because it is based on a leap from Mr. Starbody's statement that the ability to economically purchase pipeline FT capacity on a winter season-season only basis was "less clear" in April 2000 than in 2001, to a statement that the ability to economically purchase pipeline FT capacity on a winter-season only basis was "not known" at the time the decision to retire the Freeburg propane plant was made.

Second, and related to the first point, the PO's conclusion is unreasonable because it treats the PVRR issue as an "all or nothing" choice between purchasing replacement FT capacity on a 12-month basis and purchasing replacement FT capacity for only the five winter months. The PVRR savings for continued operation assuming replacement FT capacity must be purchased on a 12-month basis were \$3,942,149 for 15 years and \$5,297,160 for 30 years (PO, p. 19); in comparison, under the assumption that replacement FT capacity could be purchased for the winter season only, there are PVRR savings for retirement of \$673,952 and \$333,000 for 15 and 30 years, respectively. (IP Ex. 3.6, pp. 7-8) Thus, the use of Staff's much more conservative assumption has a dramatic impact on the results of the PVRR analysis. By treating the purchase of FT capacity on a 12-month basis as the only possible option in April 2000, the PO concludes that there are "significant PVRR savings" from the continued operation of the Freeburg plant. The PO's conclusion that there are "significant PVRR savings" for continued operation is then used to support its conclusion that those savings outweigh the concerns about the Freeburg plant's safety and reliability.⁶

⁶ IP also takes issue with the PO's conclusion that safety, reliability and other considerations were not sufficient to justify the decision to retire the Freeburg propane plant as reasonable and prudent. This point is addressed in §II.C below.

In contrast, if the PO had given some *weight* to the possibility that IP could purchase replacement pipeline FT capacity for the winter season only, it would not have found the PVRR savings from continued operation to be so “significant.” For example, the average of the results using the 12-month FT capacity cost and the winter season FT capacity cost is a PVRR savings for continued operation of \$1,634,090 for 15 years and \$2,482,080 for 30 years.⁷ These “savings” are not nearly as “significant” as those relied on by the PO, and necessitate that greater weight be given to the safety, reliability and other consideration, discussed in §II.C below, that support the reasonableness of the decision to retire the Freeburg propane facility.⁸

Third, and perhaps most importantly, the PO applies the principle that hindsight should not be used in a prudence analysis to reach an illogical and irrational result. It must be remembered that the capital expenditure decision under consideration was whether to make a capital investment of some \$1.9 million in 2000 in order to be able to continue to operate the Freeburg propane facility. Even if the ability to economically purchase replacement FT capacity on a winter season-only basis was in fact “not known” in April 2000, the availability of FT capacity on an economical basis for the winter season only was known by 2001. The logic of the PO’s analysis and conclusion is that IP should have made a

⁷ In addition, IP would realize a benefit from having the pipeline FT capacity available for the contract period (whether 5 months or 12 months) relative to the continued operation scenario. The results summarized above do not include any quantification of additional benefit.

⁸ Similarly, the PO should have given some weight to the Company’s alternative PVRR analysis that used higher capital costs for renovations and upgrades based on the report of Packer Engineering. As noted earlier in this brief, use of the higher initial capital cost estimate (\$2.5 million vs. \$1.9 million, or about 33% higher), increases the PVRR for continued operation (relative to retirement) by more than \$1.2 million over 15 years and by more than \$1.4 million over 30 years. If this alternate analysis were given weight in the PO’s

\$1.9 million capital expenditure in April 2000 in order to continue to operate the Freeburg propane plant, *even though this record shows that by the next year it would have been clear that this was an uneconomic decision.* Stated differently, the PO concludes that the “prudent” decision would have been one that this record shows would have resulted in an uneconomic and potentially “stranded” capital investment. As IP witness Mr. Starbody succinctly explained in responding to the Staff analysis:

If in April 2000 we had performed the analysis Mr. Lounsberry has presented, and relied on it as the basis for our decision, we would have committed to over \$1.8 million of capital expenditures on the assumption that our best alternative was to incur \$1,273,000 in annual costs for FT to replace the capacity of the propane plant. Within a year, it would have become clear that our best alternative was less than \$600,000 per year for replacement FT, yet the capital expenditures already would have been incurred. (IP Ex. 3.6, p. 9)

In other words, under the PO’s conclusion, if IP in April of 2000 had performed a PVRR analysis that assumed replacement FT capacity had to be purchased on a 12-month basis, and relied on that analysis to make \$1.9 million of renovations and upgrades to the Freeburg facility in order to continue to operate it, the Company would have been (under the PO’s analysis) “prudent” – but it also would have made an uneconomic decision, and saddled its customers with the obligation to pay for this capital investment over the ensuing 15 to 30 years when there were less costly alternatives. The PO’s conclusion leads to an illogical and irrational outcome, and should not be adopted by the Commission.

analysis, the “significant PVRR savings from continued operation of the Freeburg plant” would shrink even more.

C. The PO Fails to Give Sufficient Weight to the Safety, Reliability and Other Concerns Associated with Continuing to Operate the Freeburg Propane Plant; These Considerations Justified Retiring the Propane Facility

The PO concludes, appropriately, that “safety and reliability of the [Freeburg propane] plant are a legitimate concern as the plant continues to age”; but it then also concludes that “The Commission does not believe that safety and reliability concerns are so significant that they preclude the need for an economic or PVRR analysis as part of the decision as to whether the plant should be retired.” (PO, p. 18) Based on the PO’s conclusion with respect to the PVRR analyses, discussed in §II.B above, the PO’s ultimate conclusion is that “the significant PVRR savings from the continued operation of the Freeburg propane plant . . . outweigh the concerns about the safety and reliability of the plant identified by IP as the plant continues to age.” (PO, p. 19) Illinois Power takes exception to this conclusion. Particularly in light of the debatable PVRR results presented in this case, safety, reliability, flexibility and other concerns regarding the Freeburg propane facility were sufficient to warrant retiring the facility, and to show that retirement was a prudent decision.

When the Freeburg facility was placed in service, in 1971, natural gas supplies and pipeline transportation were not as readily available as they are today; propane facilities were installed to provide additional assurance of supply within IP’s service area under high demand (*i.e.*, winter peaking) conditions. (Rev. IP Ex. 3.2, p. 4) As noted earlier, by 2000, IP had already retired its other four propane plants, and the Freeburg plant had only been called upon to produce system supply gas a total of six times from 1995 through 1999. (*Id.*, pp. 4-5; IP Ex. 3.6, p. 13) While the propane plant could reasonably be expected to provide only about three days of service per five-month winter season, a replacement pipeline FT contract of equivalent capacity to that of the propane plant would provide the ability to bring

firm gas supplies into IP's system on every day of the winter season, thereby providing additional value to IP and its customers. (Id., p. 14) Thus, under current conditions, firm transportation and supply contracts are preferable from a reliability perspective. (Rev. IP Ex. 3.2, p. 4)

As IP witness Frank Starbody testified, in considering whether to make the substantial expenditures that would have been necessary to continue to operate the Freeburg propane plant, or whether on the other hand to retire the facility and rely instead on pipeline FT capacity to meet reliability needs, the Company focused primarily on safety and reliability issues and the associated costs. Safety was a concern because of the age of the facility, the fact that 800,000 gallons of propane must be delivered to and stored at the site, and the fact that over time, development had moved closer to the plant site, and could be expected to continue to come closer to the site in the future. (Rev. IP Ex. 3.2, pp. 2-3, 5; Tr. 132) Reliability was a concern because of the age of the facility, and because stricter regulatory requirements could become applicable to the facility, leading to additional costs for continued operation.⁹ (Id., pp. 2, 4; IP Ex. 3.6, pp. 13-14; Tr. 128, 132-33) Impacting both safety and reliability concerns was the need to continue to maintain an operator training program in order to have qualified personnel to operate IP's sole remaining propane facility.¹⁰ (Rev. IP Ex. 3.2, p. 3; IP Ex. 3.6, pp. 14-15)

⁹ For example, performance of major upgrades to the facility, such as those needed in 2000, could bring the plant under current versions of codes and standards rather than the earlier versions to which the plant was "grandfathered." (Tr. 127-28, 132-33)

¹⁰ Packer Engineering's safety analysis identified the need to develop a new operator training program, as well as additional costs for annual operator training. (Rev. IP Ex. 4.3, p. 4) As IP recognized, the infrequency of operation of the propane facility actually increases the need for operator training. (Rev. IP Ex. 3.2, p. 3) As Packer's report explained: "The effectiveness of operator actions in preventing or mitigating accidents decreases as the frequency of operation decreases, i.e., routine operations become non-routine. Without formalized

In deciding to retire the Freeburg propane plant, IP was concerned not only with the growth and development that had occurred in the Freeburg area over the past 30 years, but also with the likelihood that development would continue to move closer to the site over the 10 to 15 additional years the Company would need to operate the facility in order to justify the \$1,873,000 capital expenditure that would have been necessary in 2000 to keep it operating. (IP Ex. 3.6, p. 12; Tr. 122) There has been considerable growth in the populations of the two closest communities, Freeburg and Smithton, since the propane plant was installed in 1971. The popularity of the area as a “bedroom” community for St. Louis, and for developing areas of the Metro-East area in Illinois that are closer to St. Louis, has increased over the years. Freeburg is only 25 miles from St. Louis, only 12 miles from rapidly developing commercial areas on the Illinois side of the Mississippi River, and only 10 miles from Scott Air Force Base and Mid-America Airport (from where one can take the Metrolink rail system to downtown St. Louis). These are all reasonable commuting distances. (IP Ex. 3.6, p. 11; Tr. 79, 84)

In addition, the village limits of Freeburg are 2.5 miles north of the plant site on Illinois Highway 13; the area extending approximately 1.4 miles south of Freeburg has recently been re-zoned from farmland to commercial. (Id.) Highway 13 has recently been widened and resurfaced (IP Ex. 3.6, p. 11), which will enable it to accommodate more traffic. West of the plant, towards Smithton, the nearest residential development is approximately 4.3 miles away; however, there are some 27 houses along the road from the plant site to that development, including 16 within two miles of the plant site. A number of these houses have been built within the last four years. (IP Ex. 3.6, p. 11; Tr. 84-85, 123)

training and practice, the probability of operator error may increase as the operator becomes

The record also shows that continued operation of the Freeburg propane plant, which would require continued maintenance of 800,000 gallons of volatile, flammable liquid propane in an above-ground tank on site, and the equivalent of 90 tank truck deliveries to replenish the inventory after only three days of operation (IP Ex. 3.6, pp. 12-13), in a developing area, would present the risk (however remote) of a propane explosion or fire with potentially catastrophic consequences to persons or property in the surrounding area. Packer Engineering's report detailed the potential consequences of such an event:

The fact that propane exists as a liquid presents a special hazard not found with natural gas: the ability to suffer a Boiling Liquid Expanding Vapor Explosion (BLEVE). In the event of a fire caused by a leak in the propane storage system, the storage vessel can become weakened by the fire, which allows the vessel to rupture. The vessel rupture results in the spontaneous (and nearly instantaneous) vaporization of the propane liquid. The presence of a pre-existing fire nearly guarantees the ignition of the propane resulting in a devastating explosive blast and fireball.

The Freeburg facility stored approximately 800,000 gallons of liquid propane. In the event of a BLEVE, the consequences would be enormous:

- The primary fireball would measure approximately 2,100 feet in diameter.
- The explosive blast would destroy any residential or commercial structures within 1.2 miles of the facility.
- The explosive blast would break windows in residences out to a distance of 3 miles from the facility.
- The fireball would cause second degree burns to exposed human skin at a distance of 1.75 miles from the facility.

Predictions of the fire and explosion damage caused by an accident such as this contain some uncertainty. The reported distance from the facility to the nearest development (2.5 miles) is not a sufficient buffer zone distance to protect these residents from injury and/or property damage. (Rev. IP Ex. 4.3, p. 2)

Staff took the position that IP's concern about development in the vicinity of the Freeburg propane plant was not valid because existing residential development today is still a

less familiar with the facility and its equipment.” (Rev. IP Ex. 4.3, p. 3)

considerable distance from the plant site. (Staff Ex. 4.0, pp. 6-7) However, Illinois Power was concerned about the likelihood of continued significant growth and development over the lengthy period into the future that the Freeburg facility would have to be operated in order to justify the \$1.9 million worth of renovations and upgrades that the plant needed in 2000. IP was concerned not only with the current location of development in the area, but also with the likelihood that development would continue to grow towards the plant site over that period. (IP Ex. 3.6, pp. 11-12) The population growth in the area over the preceding 30 years, the ease of commuting from the area to St. Louis or to business centers in the Metro-East area, the re-zoning of land south of Freeburg from farmland to commercial, and the recent construction of new homes in the area, were all factors pointing to a continuation of growth and development in the vicinity of the plant site.¹¹

Illinois Power was also concerned that, although there had been only a small number of incidents affecting the reliability of the Freeburg propane plant over its 30-year life, reliability would become an increasing issue given the age of the facility. The Company recognized that leaks or unreliable operation would increase as the plant continued to age. Adding to this concern was the fact that the facility was called upon to operate only in severe weather conditions, and only for a few days each year. There is always a concern about the ability of equipment that is operated only sporadically to operate reliably when called upon.

¹¹ Further, while Staff focused on the proximity of residential development to the plant site, Staff's analysis gave no consideration to the persons who would be most at risk in the event of a fire or explosion at the propane facility: employees and emergency response personnel. As Dr. Ogle testified, in accidents that have occurred at other propane facilities, it is employees and emergency response personnel who have most often been injured or even killed, not bystanders in the area. (Tr. 175) In addition, Staff gave no consideration to the numerous transport truck (i.e., 90 truckloads) or tank car deliveries of propane that would need to traverse the area each time the 800,000 gallon storage vessel needed refilling.

(Rev. IP Ex. 3.2, p. 4; IP Ex. 3.6, p. 13) These types of concerns would not be present if IP were to use pipeline FT capacity to replace the capacity of the propane plant.

As Mr. Starbody, who was personally involved in the decision to retire the Freeburg propane plant, stated in describing the Company's reasoning:

Illinois Power determined that, as the Freeburg-Smithton area continued to grow, operation of an aging propane facility presented liability risks that the Company did not want to accept [T]he same supply capacity can be obtained through FT (or pipeline leased storage) without the need to continue to be responsible for managing a large volume of flammable, volatile substance, and with less risk and more convenience in other respects as well. (IP Ex. 3.6, p. 14)

Illinois Power submits that the safety, reliability, flexibility (associated with having the replacement FT capacity available for the entire winter) and other considerations summarized above are serious and substantial. The Company believes that given the need to make at least \$1.9 million of renovations and upgrades to continue to operate the facility (as well as the need for additional expenditures in future years to keep the plant operational), these concerns were sufficient to justify retiring this 30 year-old facility in 2000. The PO simply fails to give these considerations sufficient weight in its analysis of whether retirement of the Freeburg propane facility is a reasonable and prudent decision. Particularly in light of the debatable nature of the PVRR results presented in this case, the PO's conclusion that these considerations were "outweigh[ed]" by the "significant PVRR savings from continued operation" is not reasonable, nor one the Commission should adopt. Instead, the Commission should conclude, based on the entire record, that the retirement of the Freeburg propane plant was a reasonable and prudent decision.

III. THE PO'S CONCLUSION THAT IP'S METHOD OF SELECTING WINTER SEASON CAPACITY RESERVATION CONTRACTS WAS IMPRUDENT SHOULD NOT BE ADOPTED BY THE COMMISSION

The firm gas supply portfolio that Illinois Power develops for each winter season includes a number of “swing” firm supply reservation contracts. These “swing” contracts guarantee the buyer that supply will be available in the amount purchased under the contract, but do not obligate the buyer to actually take any gas commodity under the contract. (Rev. IP Ex. 3.2, p. 12) IP enters into these “swing” contracts for the purpose of guaranteeing sufficient supply reservation, but does not enter into these contracts with the intention of actually buying substantial amounts of gas under these contracts. Rather, since the Company is not obligated to purchase any gas under any of the swing contracts, it continues to search the market for commodity from alternative sources, at prices lower than the commodity prices specified in the swing contracts. IP continues to monitor and search the market on a monthly and daily basis for opportunities to purchase commodity at lower prices, and it ultimately purchases the least expensive delivered supply available.¹² As a result, except under severe winter conditions, little or no commodity may in fact be taken under any particular firm supply reservation contract. (IP Ex. 3.1, pp. 3-4; Rev. IP Ex. 3.2, pp. 12-13)

The “swing” contracts specify a daily reservation fee that must be paid throughout the term of the contract, even if no gas is taken. Because IP does not enter into the firm supply reservation contracts with the expectation of buying substantial gas under those contracts (or of buying a particular amount of gas under any particular contract), IP does not take the commodity prices specified in these contracts into account in deciding which contracts to

¹² IP may even wind up purchasing spot gas from a supplier with whom it has a firm supply reservation contract, at a lower price than specified in the firm reservation contract. (Rev. IP Ex. 3.2, p. 13)

enter into. Rather, IP selects the “swing” contracts it enters into based solely on the lowest reservation fee bid among the potential suppliers for particular delivery points.¹³ (IP Ex. 3.1, pp. 3-4; Rev. IP Ex. 3.2, pp. 12-13)

Given the purpose of the “swing” contracts, the fact that the reservation fee must be paid throughout the term of the contract, the fact that IP is not required to purchase gas under these contracts but rather can and does obtain commodity from alternate, lower-priced sources, and the likelihood that little or no gas may be purchased under a swing contract, the selection of swing contracts based solely on lowest reservation charges is a prudent purchasing practice. (*Id.*) In fact, the order in last year’s (1999) PGA reconciliation case for IP included the following discussion:

Mr. Brian Blackburn sponsored IP Exhibit 3.1, including Attachment 3.2 thereto (“1999 Pipeline Services”), and IP Ex. 3.1-DR. With regard to IP’s natural gas procurement activities in 1999, Mr. Blackburn stated that IP purchased 59.0 million MMBtu of natural gas from various producers and marketers. He said IP reserves firm natural gas supply for the winter months pursuant to contracts with suppliers providing the lowest reservation costs. Purchases under these contracts are typically priced at applicable market indices, using either a first of the month index or a daily index. He stated that IP continues to search the market throughout the winter, and will purchase more economically priced gas wherever possible. (Order in Docket 99-0477 (May 23, 2001), p. 3; emphasis supplied)

* * * *

Mr. Eric Lounsberry of the Engineering Department of the Commission’s Energy Division stated that Staff reviewed IP’s filing and the Company’s responses to numerous data requests concerning the prudence of IP’s gas purchases during the reconciliation period. He indicated that Staff found no reason to dispute IP’s assertion that all its gas supply purchases during that period were prudently incurred. (*Id.*, p. 4)

* * * *

¹³ IP has followed the practice of selecting firm supply reservation contracts based solely on lowest reservation costs for a number of years. (Rev. IP Ex. 3.2, p. 12)

- (4) the evidence indicates that IP acted prudently in its purchases of natural gas during calendar year 1999. (Id., p. 5)

In this docket, however, Staff contended that the practice of selecting the firm supply reservation contracts solely on the basis of lowest reservation cost is imprudent, and that the Company should in some manner take into account the commodity prices specified in the swing contracts offered to it when deciding which offers to accept. (Staff Ex. 2.0, pp. 19-20; Staff Ex. 4.0, pp. 22-24) The PO agrees with Staff, reaching the following conclusion:

The Commission concludes that IP's practice of awarding swing firm supply contracts for the 2000-2001 winter season on the sole basis of lowest reservation costs was imprudent. IP should have also considered commodity costs in awarding such contracts. While it may be difficult to estimate the amount of gas that will be taken under any particular swing contract, IP's selection criteria wrongly assumes that no gas will be taken. When IP entered into the swing contracts for the 2000-2001 winter season, it knew that it purchased gas under each of its swing contracts for the 1999-2000 winter season at the load factors listed in the preceding paragraph. The Commission does not find that Staff's method for considering the commodity costs is the only or best way to do so. Rather, based on the evidence, the Commission finds that Staff's method is more reasonable than ignoring such costs. Therefore, the Commission finds that Staff's proposed disallowance of \$3,000 is reasonable and is approved. (PO, p. 34)

The PO's conclusion is ill-considered and erroneous, and should not be adopted by the Commission. First, the PO's conclusion fails to address the fact that IP has been employing the same practice for several years and that in the prior year's PGA reconciliation case this practice was accepted by Staff and found to be prudent by the Commission. As was the case with the PO's analysis of the Freeburg retirement decision, the PO's conclusion here would hold the Company's actions to be imprudent, and impose a disallowance, even though the same purchasing practice was accepted as prudent in last year's reconciliation. As a matter of rational and predictable regulation, the Commission must consider that it is extremely difficult for utilities to identify acceptable standards of conduct to which to conform their practices, when practices accepted as prudent in one year are challenged as

imprudent in the very next year. Adoption of the PO's conclusion would not represent rational and predictable regulation.

Second, the PO's conclusion that "IP's selection criteria wrongly assumes that no gas will be taken" under each swing contract misses the point. The issue is not whether some (versus no) gas will be taken under these contracts. Rather, the issue is how to predict how much gas is likely to be taken under each swing contract. In order to take the commodity prices in the competing offers into account, there must be a reasonable and reliable basis for estimating how much commodity gas is likely to be taken under each swing contract. Contrary to the PO's inference, there is not such a basis, because the amount of gas that is taken under each contract is highly variable, and unpredictable.

While one could engage in the exercise of taking the commodity prices specified in the firm supply reservation bids into account by applying them to an amount of capacity expected to be purchased under the contract, such an exercise would not be useful. The volume of gas, if any, that may be purchased by IP under these "swing" contracts will depend on numerous factors, including weather during the succeeding winter season, spot versus firm gas prices, basis differentials (i.e., the price differential, if any, for gas delivered from different pipeline receipt points), and the prices that can be obtained from suppliers on a daily basis. (Rev. IP Ex. 3.2, p.13) The accuracy and reliability of any estimate of the amount of gas that might actually be purchased under a "swing" contract, and thus the accuracy and reliability of the resultant commodity cost calculations, would be completely overwhelmed by the uncertainty of the assumptions that went into it. (Id., pp. 13-14; IP Ex. 3.6, p. 26) This reality is manifested by examining the actual load factors (i.e., the actual amount of gas purchased versus the amount that could have been purchased based on the contract

reservation amounts) under the “swing” contracts IP entered into for the 1999-2000 and 2000-2001 winter seasons:

- For the 1999-2000 winter season, IP entered into 16 swing contracts. Their actual load factors ranged from 15% to over 58%, with an average of 26.8%. (IP Ex. 3.6, p. 25)
- For the 2000-2001 winter, IP entered into 18 swing contracts. Their actual load factors ranged from less than 1% (two contracts) to over 90% (four contracts), with an average of 56.1% (more than twice the previous winter’s average). (*Id.*)
- For the five swing contracts IP entered into for the 2000-2001 season based on lowest reservation cost even though the next best reservation cost bid had a lower commodity price, the actual load factors were 0%, 1%, 34%, 43% and 98%.¹⁴ (Rev. IP Ex. 3.2, p. 15)

Obviously, there is simply no predictability to the “expected” load factor for any particular contract. Indeed, as the above data illustrate, if IP had attempted to forecast the amount of commodity that would be taken under its firm supply reservation contracts for the 2000-2001 winter based on its experience in the 1999-2000 winter, its estimates would have been seriously in error.

Thus, Illinois Power strongly disagrees with Staff and the PO that consideration of the commodity prices specified in the swing contract proposals would result in improved decision-making in the selection of these contracts. The record does not support the PO’s conclusion that IP’s practice of selecting these contracts based on lowest reservation cost is imprudent.

Further, even if the Commission were to conclude that Illinois Power’s practice of selecting firm supply reservation contracts on the basis of lowest reservation cost were

¹⁴ These data illustrate that the PO’s statement that “IP’s selection criterion wrongly assumes that no gas will be taken” is not correct. For some swing contracts, it has turned out that no commodity gas, or virtually no gas, is taken.

imprudent, there should be no resulting gas cost disallowance in this case. As noted above, IP entered into 18 swing contracts for the 2000-2001 winter season, all on the basis of lowest reservation cost. Thirteen of these 18 contracts also had the same or lower commodity prices than were offered to IP by the bidder offering the next lowest reservation cost. Thus, by definition, regardless of the amount of gas taken under these 13 contracts, IP realized lower total costs than if it had taken the proposal with the next best reservation cost. For the remaining five contracts in the aggregate, based on the amount of gas actually purchased, IP realized a **total savings** of \$16,815 during 2000, as compared to the costs IP would have incurred had it taken the proposals with the lower commodity prices. (Rev. IP Ex. 3.2, p. 15; IP Exs. 3.4-3.5)

Although acknowledging this fact (Tr. 57), Staff looked only at the two contracts for which (per Staff's calculations) IP incurred higher total costs than if it had taken the proposals with lower commodity price, and proposed as a disallowance the "losses" on those two contracts.¹⁵ The PO adopts Staff's disallowance recommendation. However, Staff, and the PO, completely ignored the savings IP realized on the other 16 contracts that IP selected through consistent application of its criteria of lowest reservation costs, as well as the

¹⁵ Staff's calculation that there were higher costs incurred on one of these two contracts was erroneous. The contract that IP entered into was for a specified firm supply reservation amount. The next best offer, which had a higher reservation cost but lower commodity price than the winning bid, was for only about one-half of the firm supply reservation amount as the winning bid. Staff compared the cost paid under the winning contract for gas actually taken to the lower cost for that gas that would have been paid under the next best bid, but erroneously compared the reservation cost paid under the winning contract to the reservation cost that would have been paid under the next best offer for only half the reservation amount of the winning contract. (IP Ex. 3.6, p. 26; see Staff Ex. 4.0, Sched. 12.0) In order to do a proper comparison for this contract, it was necessary to include the third best offer as well in order to get the total amount of firm supply reservation provided by the winning contract. This analysis, which was presented by the Company, showed that the winning contract

aggregate savings that IP realized on all 18 contracts. (See IP Ex. 3.6, p. 27) If the Commission thinks the Company's uniformly-applied practice of selecting firm supply reservation contracts solely on the basis of lowest reservation costs is imprudent (which, as shown above, it is not), any resulting disallowance should be based on the aggregate excess costs, if any, incurred on all the contracts that IP selected based on this practice – not just on a selected subset of those contracts. The record shows that in the aggregate there were no excess costs incurred as a result of this practice.

IV. SPECIFIC EXCEPTIONS TO THE PROPOSED ORDER

A. Retirement of the Freeburg Propane Facility

For the reasons set forth in §II above, the following changes should be made to §IV.B.4 of the Proposed Order.

1. The third and fourth paragraphs in §IV.B.4 of the PO should be deleted in their entirety and replaced with the following language:

The Commission believes that in examining the prudence of a utility decision in a PGA reconciliation proceeding, it is appropriate to consider whether a PVRR analysis of the decision should be conducted. Factors that should be considered include the size of the capital investment being evaluated and the significance of other factors to the decision being considered. In this case, IP has pointed out that in prior cases before this Commission involving the prudence and reasonableness of capital projects larger than the capital expenditure that would have been needed in order to continue to operate the Freeburg propane facility, the Commission has not required PVRR analyses or other net economic benefits analyses in order to justify the project as prudent and reasonable. The Company has also pointed out that it previously retired four other propane plants without conducting or presenting PVRR analyses of those decisions, and neither the Staff nor the Commission called for PVRR analyses to be done. The Company contends that based on this prior experience, it would be unreasonable for the Commission now to conclude that a PVRR analysis should be conducted in connection with retirement of the Freeburg facility. Finally, IP contends that safety, reliability, flexibility and other considerations were significant enough to

produced a savings in 2000 over the next best offers for the same capacity reservation amount. (Rev. IP Ex. 3.2, pp. 14-15; IP Ex. 3.4)

justify the retirement decision as reasonable and prudent, and that a PVRR analysis should not be required. The Commission concludes that, based on the facts and circumstances involved in the retirement of the Freeburg propane plant, a PVRR analysis is not necessary.

2. In the fifth paragraph in §IV.B.4 of the PO, the last two sentences should be deleted.

3. The tenth paragraph in §IV.B.4 of the PO should be deleted and replaced with the following language:

Based on its review of the evidence concerning the safety and reliability of the Freeburg propane plant, and the other considerations cited by IP in support of the decision to retire the facility, the Commission determines that safety and reliability of the plant are a legitimate concern as the plant continues to age. As indicated earlier in this section, the safety, reliability and other concerns, along with other factors cited earlier, lead the Commission to the conclusion that in the circumstances of this case, a PVRR analysis of the Freeburg propane plant retirement is not necessary to determining whether the decision to retire the facility was prudent and reasonable.

4. The eleventh paragraph in §IV.B.4 of the PO should be revised as follows:

Although the Commission has concluded that a PVRR analysis is not necessary under the circumstances of this case in connection with the retirement of the Freeburg propane facility, PVRR analyses were presented in this record by Staff and IP; therefore, the Commission will address those studies. Turning to the PVRR analyses presented in this proceeding, the Commission notes that IP's base case analysis indicates that the PVRRs for continued operation of the Freeburg plant are \$5,630,160 for the 30-year period and \$4,616,201 for the 15-year period. Staff indicates that these PVRR values most closely reflect Staff's final position. In addition, IP presented an alternative analysis using higher initial capital expenditures in order to continue to operate the facility, based on the analysis performed by Packer Engineering. In this alternate analysis using higher initial capital costs, the PVRR for continued operation of the Freeburg plant increased by \$1,264,947 over the 15-year period and by \$1,412,658 over the 30-year period. **[Remainder of paragraph unchanged]**

5. The twelfth and thirteenth paragraphs in §IV.B.4 of the PO should be deleted in their entirety and replaced with the following language:

The difference between IP's and Staff's PVRRs for the retirement of the plant is due to the fact that IP assumed that it would need to buy pipeline FT capacity for

only the five winter months at a cost of \$588,126, while Staff assumed that IP would need to buy the pipeline FT capacity for all 12 months of the year at an annual cost of \$1,273,000. Staff notes that winter only service comes at a premium and that IP may not be able to receive any discount from maximum rates for winter only service. IP states that it has appropriately reflected the premium price that must be paid for winter-only FT service in its calculation of the cost. IP acknowledges that it has found it difficult in the past to economically lease pipeline capacity on less than a 12 month basis, and that the ability to do so was less clear in April 2000 than it is in 2001, but contends that the market has evolved so that it is economical to purchase FT capacity for the winter season only (November through March) albeit at a premium over the summer season (April through October) rates. The ability to purchase replacement FT capacity for the winter season only is clearly the more reasonable assumption as of the present time; it would be irrational for the Commission to conclude, based solely on the results of a PVRR analysis that assumes that replacement FT capacity can only be purchased on a 12-month basis, that retirement of the Freeburg plant was imprudent, and therefore that IP should have made a capital expenditure of some \$1.9 million in 2000 in order to continue to operate the plant, when the record indicates that today it is possible to buy pipeline FT capacity for the winter season only at a lower total cost than on a 12-month basis. The record does reflect that it is less clear whether purchase of replacement FT capacity for the winter season only would have been a reasonable or foreseeable assumption as of early 2000. For purposes of considering the impact of the PVRR analyses, the Commission will take both the PVRR analyses of retirement presented by Staff (which show a PVRR advantage to continued operation) and the PVRR analyses presented by IP (which show a PVRR advantage to retirement) into account. In addition, as noted above, the alternate analyses presented by IP based on higher initial capital costs increase the PVRR for continued operation by over \$1.2 million over 15 years and by over \$1.4 million over 30 years, and show a PVRR savings for retirement of the facility. The Commission believes that proper use of PVRR analyses should take into account PVRR values for a number of plausible alternative scenarios

The Commission has previously noted that considerations relating to safety and reliability as well as other considerations were sufficient to justify the decision to retire the Freeburg propane facility as reasonable and prudent. The Commission concludes that the ambiguous results of the PVRR analyses presented by the parties do not change this conclusion. Accordingly, the Commission concludes that the retirement of the Freeburg propane plant was reasonable and prudent.

6. If the foregoing revisions to the PO are accepted, then the last paragraph in §IV.B.4 of the PO should be deleted in its entirety.

B. IP's Practice of Awarding Firm "Swing" Gas Supply Reservation Contracts on the Basis of Lowest Reservation Cost

1. For the reasons set forth in §III above, the third paragraph in §IV.D.5 of the PO should be deleted in its entirety and replaced with the following language:

The Commission concludes that IP's practice of awarding swing firm supply reservation contracts for the 2000-2001 winter season on the sole basis of lowest reservation costs was prudent. The Commission would have a difficult time concluding that this practice was imprudent for 2000 when the practice was reviewed and found to be prudent in the prior's year's (1999) PGA reconciliation case. However, evaluating this practice on its merits, IP has demonstrated that the amount of gas commodity that will be purchased under any particular swing contract is dependent on numerous factors that impact winter season gas usage and prices, and is therefore totally unpredictable. Staff has not contradicted that demonstration. The fact that IP could calculate a "break-even" load factor for each swing contract does not mean that IP's decision-making would be improved by taking commodity pricing into account, because it would still be necessary for IP to estimate whether the likely gas usage under each contract would be above or below the "break-even" load factor, and this is the estimate that is fraught with uncertainty. The record shows that for the 2000-2001 winter season, the actual load factors of the 18 swing contracts ranged from 0% to 98%. Moreover, the record shows that for the five swing contracts that IP selected even though the contract offer with the next lowest reservation cost had a lower commodity price than the selected contract, and the actual gas usage during 2000 under each of the five contracts selected, IP realized an aggregate savings of \$16,815 as compared to the costs IP would have incurred had it taken the contract offers with the lower commodity prices. (Rev. IP Ex. 3.2, p. 15; IP Exs. 3.4-3.5)

2. If the foregoing exception is not adopted, then the last sentence of the third paragraph in §IV.D.5 of the PO should be deleted and replaced with the following language:

However, despite the Commission's conclusions with respect to IP's practice of selecting "swing" contracts based solely on lowest reservation cost, the record shows that for the five swing contracts that IP selected even though the contract offer with the next lowest reservation cost had a lower commodity price than the selected contract, and based on the actual gas usage during 2000 under each of the five contracts selected, IP realized an aggregate savings of \$16,815 as compared to the costs IP would have incurred had it taken the contract offers with the lower commodity prices. (Rev. IP Ex. 3.2, p. 15; IP Exs. 3.4-3.5) Therefore, the Commission concludes that there were no unreasonable or imprudent gas costs incurred as a result of this practice during the 2000 reconciliation year.

C. Findings and Ordering Paragraphs

1. Finding (4) should be revised as follows:

(4) the evidence shows that for the calendar year 2000 reconciliation period, Illinois Power acted reasonably and prudently in its purchase of natural gas, ~~except with regard to its decision to retire its Freeburg propane plant and its method for selecting swing firm supply reservation contracts;~~

2. Finding (5) should be deleted in its entirety and replaced with the following language:

(5) The reconciliation of revenues collected under IP's PGA tariff with the actual cost of gas prudently purchased for the calendar year 2000 reconciliation period as presented on IP Exhibit 2.2 and summarized in Section III of this Order, should be approved.

3. Finding (6) should be deleted.

4. The first ordering paragraph should be revised to read as follows:

IT IS THEREFORE ORDERED that the reconciliation of revenues collected under IP's PGA tariff with the actual cost of gas prudently purchased for the calendar year 2000 reconciliation period as presented on IP Exhibit 2.2 and summarized in Section III of this Order, is approved.

5. The second ordering paragraph should be deleted.

D. Technical/Typographical Corrections

1. In the second paragraph of §IV.C.2.a of the PO, the number "\$1,999,000" should be \$1,199,000, (See Rev. IP Ex. 3.2, p. 8)
2. With respect to Finding (6) in the PO (which IP has recommended be deleted), the number "\$900,915" is incorrect and should be \$900,195. (See Appendix A to PO, Line (14), Col. (C)).

V. CONCLUSION

For the reasons set forth in this Brief on Exceptions, the Proposed Order should be modified in accordance with Illinois Power Company's exceptions and argument herein, and as so modified, should be adopted by the Commission as the final Order in this docket.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I, Owen E. MacBride, certify that on the 31st day of October, 2001, I served a copy of Illinois Power's Brief on Exceptions to the Proposed Order by e-mail, to the individuals on the service list attached.

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